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Statement of

Scott M. Polakoff, Deputy Director
Office of Thrift Supervision

concerning

The Credit Union Charter Choice Act, H.R. 3206

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

House Financial Services Committee

May 11, 2006

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Testimony on the Credit Union Charter Choice Act, H.R. 3206
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I. Introduction

Good morning, Mr. Chairman, Ranking Member Sanders, and members of the Subcommittee. Thank you for the opportunity to testify on the Credit Union Charter Choice Act, H.R. 3206, sponsored by Representatives McHenry and Gillmor, among others, and the role of the Office of Thrift Supervision (OTS) when a credit union or other entity seeks a savings association charter.

Charter choice is a fundamental precept at OTS. Since the agency was established in 1989, many institutions have both left and entered the thrift charter. These so-called "charter flips" are a normal course of business at OTS and throughout the banking industry. In our view, it is the role of the regulator to minimize regulatory obstacles, reduce burden and facilitate legitimate business decisions regarding charter choice made by the institutions we regulate.

While I cannot represent the views of the other federal banking agencies (FBAs) regarding the issue of charter choice, I can tell you that all of the FBAs handle the charter flip conversion process similarly. That is, each requires an application to obtain a charter within their jurisdiction, but not to leave their jurisdiction and oversight. While an agency may pass on supervisory and regulatory information to a new regulator, there is generally not a requirement that an institution obtain permission from one of the FBAs to leave its jurisdiction, except where an institution has pending enforcement or similar issues or is in potentially troubled condition.

In my testimony today, I have been asked to describe for you the charter conversion process at OTS, as well as the mutual-to-stock and mutual holding company (MHC) conversion processes in place at OTS. I will also address issues relating to membership rights of mutual account holders, or members, of a mutual savings association, and benefits to management insiders when a mutual savings association converts to a stock institution or into a MHC structure. Finally, I will conclude with some general observations about H.R. 3206 in light of the discussion of the various OTS conversion processes and comparing these to the requirements of the proposed legislation. But first, I will highlight our general understanding of the provisions of the bill.

II. Summary of H.R. 3206, the "Credit Union Charter Choice Act"

The Credit Union Charter Choice Act is designed to clarify the communications between credit unions and their members. Specifically, the legislation requires that notifications to members of a credit union regarding a proposed conversion should include the following:

- the date that the membership vote will be taken and the date by which ballots must be received by the inspector of elections;
- a brief statement of why the directors of the converting credit union are considering the conversion and the board's recommendation to the members; and
- a brief statement of the material effects of the conversion on the credit union, as converted, and the members, including any differences in powers between a credit union and a savings association.

The bill also clarifies that a credit union may not be required to include in a conversion notice any information or statements that:

- are speculative with respect to the future operations, governance, or form of organization of the institution;
- are inaccurate with respect to a proposed conversion;
- conflict with regulations of other regulators with regard to the subsequent conversion of the institution from mutual to stock form;
- distort the impact of conversion on the members of the credit union; or
- are attributable to the National Credit Union Administration (NCUA) or state the NCUA's position on conversions.

Generally, the bill streamlines the review and approval process conducted by the NCUA regarding conversion materials submitted by converting credit unions to the NCUA. In addition, the legislation requires a credit union's member vote on a conversion to be conducted by secret ballot, with an independent inspector of elections appointed by the credit union to receive and tally the votes. The bill effectively denies the NCUA any further review or approval authority over the conversion process, absent fraud or reckless disregard for fairness during the voting process that affects the vote outcome.

III. OTS and the Thrift Industry: A Legacy of Charter Choice

OTS oversees an industry and charter that is primarily engaged in retail banking; or, more precisely, retail community banking. The savings association charter is a vital and growing choice in the financial services world, and an important resource for economic growth in this country. The industry is rapidly growing, with total assets up 12.0 percent in 2005 from the prior year to a record $1.46 trillion. In the past five years, industry assets grew 57.7 percent, representing a robust average annual growth rate of 9.5 percent.

Earnings were also strong last year, and have been strong for the last five years. For 2005, earnings were up 17.6 percent from 2004, and the industry earnings more than doubled the last five years, climbing from $8.0 billion in 2000 to a record $16.4 billion in 2005.

Throughout the history of the OTS, there have been many institutions that have left the thrift charter, and many that have opted for the thrift charter as the choice for conducting their ongoing business operations. From 2000 to 2005, there were 90 institutions that converted from the thrift charter to another type of depository institution charter, and 51 institutions that converted to the thrift charter from another type of depository institution charter. Of the 51 institutions opting for the thrift charter, 9 were credit unions and the rest were banks. Clearly, charter choice is a fundamental aspect of the U.S. banking system.

As the retail community banking sector grows, the savings association charter is well positioned to provide a structural and regulatory alternative both for established financial services businesses and for new entrants that are working to grow market share in this area. The savings association charter is remarkably flexible in adapting to the many products and structures present in today's financial services marketplace. It is deployed in neighborhoods all across America, and is also used by leading nationwide lenders, by investment banks offering a full array of financial services, and by global conglomerates involved in a wide array of diverse businesses. These organizations have all come to the savings association charter at different times and for reasons as diverse as their underlying businesses and the markets they serve.

At the same time, there are numerous institutions that seek to conduct their business operations in a different charter form, and OTS supports the ability of any institution to gravitate to the charter that best serves its business needs and interests.

As long as applicants meet all of the necessary regulatory requirements to create or convert to a savings association, or to opt for another charter type, we strongly support such a choice, and support any legislation that promotes such freedom of choice.

IV. The OTS Charter Conversion Process

Conversions of banks or credit unions to become OTS chartered institutions are generally subject to the same standards for approval as applications for permission to organize a new, or de novo, savings institution.

In summary, OTS regulations authorize credit unions to convert directly to federal mutual savings associations. The institution must have its deposits insured by the FDIC upon completion of the charter conversion and comply with all applicable federal or state laws and OTS policies, and obtain all required regulatory and member approvals.

In addition, the Home Owners Loan Act (HOLA) and OTS regulations set forth standards that OTS must consider when granting a federal charter. Because a credit union conversion requires a new federal charter, OTS must consider these standards. The HOLA states that OTS may grant a charter only if all of the following criteria are satisfied:

- the organizers are persons of good character and responsibility;
- a necessity exists for the savings association in the community to be served;
- there is a reasonable probability of the savings association's usefulness and success; and
- the savings association can be established without undue injury to other local thrift and home-financing institutions.

In addition, OTS regulations provide that OTS must consider whether the savings association will perform a role of providing credit for housing consistent with the safe and sound operation of a federal savings association.

Furthermore, OTS Community Reinvestment Act regulations provide that an applicant for a federal thrift charter must submit with its application a description of how it will meet its CRA objectives. OTS must take the CRA description into account when considering the application, and may deny or condition the application on CRA grounds.

Applications by credit unions to convert to federal savings associations are also subject to publication and public comment requirements. In addition, OTS is required to verify, under statutes and regulations applicable to credit unions, the member vote concerning conversions of credit unions to federal mutual savings associations.

Membership Rights

An issue often raised in conversions of credit unions to federal mutual savings associations is the rights of credit union members relative to those of federal mutual associations. Certain parties have advanced various reasons why they believe credit union members' rights are compromised when a credit union converts to a federal mutual savings bank.

Much has been made of the fact that credit union voting is conducted on a one vote per member basis, while the federal mutual charter provides for one vote per $100 on deposit, with the association being able to set, in its charter, the maximum number of votes per member at any number from one to one thousand. In our view, this type of voting provision, while different, is at least as equitable as the one member-one vote rule, since it provides greater voting rights, up to a limit, to members that have made a greater contribution to the institution. We believe it is appropriate for an institution to have the flexibility to provide for voting rights based on the extent of the depositors' relationship with the institution.

It is important to note that even though some depositors may have a greater number of votes than others, even in a relatively small institution no accountholder with the maximum number of votes could have any appreciable amount of control of an institution. The smallest credit union to convert to a federal mutual association had assets of approximately $8 million. Even assuming deposits with voting rights totaling $7 million, and a depositor with $100,000 on deposit having 1000 votes, the maximum percentage of votes of a depositor/member would be less than 2 percent of the voting rights of the institution. Only three of the credit unions that converted to a federal charter had assets of less than $20 million. OTS has not reviewed a credit union conversion in which a depositor could have any control of the vote.

Another issue that has been raised is the fact that members of federal mutual associations may, in most matters (excluding mutual-to-stock conversions and mutual holding company reorganizations), vote by proxy, while credit union members vote by mail ballot. We do not find this to be a meaningful distinction. Members of mutual associations, through proxies, may specify exactly the way they wish to vote. The fact that depositors also have the flexibility to grant management discretionary authority with respect to their vote does not make the voting process less meaningful. While federal mutual associations are able to use running proxies, members may revoke those proxies or use new proxies. The membership voting interest of mutual savings associations is no less meaningful simply because members may use proxies.

The economic nature of membership interests in mutual associations and credit unions is quite similar. The moment a person becomes a depositor/member of either type of entity, the person has the same rights as other members to participate in dividends, or any liquidation of the entity. The moment the person ceases to be a member, they have no continuing interest in the institution. Membership interests in either entity cannot be transferred. Members of either entity cannot compel management to declare dividends. In addition, although liquidations of either type of entity are extremely rare, it is worthwhile to note that liquidation rights in both entities are similar, with depositors sharing in any equity remaining after a voluntary liquidation in proportion to the amount of their deposits. This is a practice consistent with providing greater voting rights to members with a greater deposit investment in an institution.

V. The OTS Process for Mutual-to-Stock and MHC Conversions

The HOLA permits mutual savings associations to convert to the stock form of organization. The statute also permits savings associations to reorganize into MHC form, and to conduct a minority stock issuance of less than 50 percent of the institution's stock. Such transactions are subject to significant regulatory and disclosure requirements.

Since the conversion program began in 1972, mutual-to-stock conversions and minority stock issuances have raised over $35 billion in new capital for the industry. These transactions have enabled savings associations to raise additional capital in a short period of time, rather than raise additional capital slowly, through earnings. In addition, the conversion process enables converted thrift institutions to attract top management by the use of stock benefit plans that formerly were only available to commercial banks and other stock chartered entities.

Today's regulatory system is a result of decades of experience and is designed to produce a fair result to all parties -- depositors, the community at large, new stockholders, and others.

It is important to point out that the mutual to stock conversion process is designed to protect the interests of the institution's mutual accountholders. Conversions and MHC reorganizations must be approved by an association's accountholders, by a majority of the institution's eligible votes. The accountholders are provided detailed, comprehensive disclosures regarding the transaction. Significantly, accountholders are provided priority subscription rights in the conversion stock offering. Furthermore, the converting association establishes a liquidation account in the conversion, which reflects the value of the institution immediately prior to the conversion.

Every conversion begins with an independent appraisal of the mutual institution. That appraisal determines a fair value for the institution as a converted entity. The appraiser presents the results of its analysis to the board of directors of the institution, who vote on the valuation and submit it as part of their application to convert.

Individual members (or depositors) of a mutual thrift institution that determines to convert, are given first priority rights, as noted above, to subscribe for stock based on having a deposit account at the institution at least one year prior to the board of directors vote on a plan of conversion. After the subscription orders of the members are satisfied, a tax-qualified employee stock benefit plan is permitted to purchase shares on behalf of the employees of the institution. The next priority is for depositors who had deposits at the institution fifteen months later than the first priority depositors. Next, any other depositors/members of the mutual thrift who had not been included in earlier categories are given the opportunity to subscribe for shares, i.e., after the subscriptions of earlier subscribers have been satisfied and shares remain. Finally, a community offering may be conducted at the same time as the subscription offering, or later, with any remaining shares sold to natural persons residing in the local community.

It is important to note that management may participate in an offering if they are also depositors, or later as members of the community, and that management purchases are limited by OTS regulations. In addition, management may also participate in stock benefit plans, but only if the stockholders of the newly converted entity passed such plans at least six months following a conversion. OTS regulations strictly limit the amount of shares permitted for employee stock benefit plans, to assure that the reason for the conversion is not simply to provide shareholder benefits to management.

A critical aspect of the conversion process is preparation of a business plan that shows how the institution intends to deploy the proceeds from the offering during the three years after the conversion.

OTS considers its conversion program to be a tremendous success. While we are strong supporters of mutuality, a mutual-to-stock conversion is the right business strategy for some institutions. For those that choose to convert, OTS' conversion program has been a win-win proposition for all parties.

Mutual institutions that have undertaken the conversion process have been able to raise substantial sums of new capital to grow their businesses. In addition, as part of that process they have been able to compete with other stock institutions by offering management stock benefits to attract top quality managers. By encouraging the use of tax-qualified employee stock ownership plans, OTS has seen the employees who work at the institution be able to participate in the stock offering and become owners of their company. Communities have benefited from conversion transactions, because converted institutions have grown, opening new offices and providing additional services in their communities. Finally, the regulatory system has benefited from the strengthened balance sheets of the institutions we regulate.

Limitations on Management Benefits

As noted above, management benefits are limited in a mutual-to-stock conversion or minority stock offering. Most importantly, before a conversion or MHC stock offering occurs, the members of the institution must approve the transaction. Full disclosure is provided regarding all aspects of the transaction, including management benefits. If the membership objects to management benefits, they may vote against the transaction.

Most managers are also depositors of the institution, and when they purchase stock in the institution, they purchase subject to the same terms that are applicable to other members. All purchases, including those by management, are subject to maximum limits so that no party acquires control in the conversion. In addition, purchases by all managers are subject to an aggregate limit. In rare cases where a manager is not a depositor, the manager's purchase rights are subordinated to those of the members.

Converting savings associations also establish employee stock ownership plans in mutual-to-stock conversions. These are tax qualified employee benefit plans, and are subject to requirements regarding distribution of stock under the plans. Congress has encouraged the use of these plans, and we believe they are no less appropriate for newly converted stock associations than they are for any other type of entity. As I noted earlier, these transactions are subject to member votes, so that if members object to the transaction, they may vote it down.

The institution may also establish management recognition and stock benefit plans after the conversion. OTS regulations provide that these may not be established until at least six months after the conversion. These plans are subject to a separate shareholder vote.

OTS believes that it would be inappropriate to prohibit institutions from establishing these plans after a conversion or minority stock offering. These institutions compete on the same basis as other stock entities, and these benefit plans enable management to retain and attract qualified management in the same manner as other stock entities.

VI. Observations on H.R. 3206 in Light of the OTS Experience

OTS supports all efforts to ensure effective communications between an institution considering a charter conversion and its members. A charter conversion is an important business decision for any institution, and membership input is critical both to inform management regarding member support for a proposed conversion as well as to ensure members will continue to support the institution after a conversion. In our view, H.R. 3206 sets forth a clear set of guidelines that clarify appropriate standards of conduct in communications between an institution and its members. Fundamentally, sound communications assist in the formulation of sound decisions regarding the members rights to exercise their freedom of charter choice.

H.R. 3206 is consistent with existing OTS information requirements and standards of conduct for member communications in connection with mutual-to-stock and MHC conversions. Generally, OTS rules incorporate by reference the disclosure requirements of the federal securities laws. The rules require a meaningful disclosure of all relevant information in connection with a conversion, including the disclosure of potential risk factors and future business plans of an institution. The rules also make clear that disclosures must be clear, accurate, balanced, and not so forward-looking as to be speculative in nature. Again, the bottom line is that all disclosures must be meaningful. We believe this is a good standard to follow.

For example, requiring detailed disclosures on potential future business plans that may or may not happen serves no meaningful purpose. While it is certainly appropriate to highlight the possibility of future transactions, requiring detailed information on the downsides of such a future transaction and barring discussion of the upside is, in our view, not meaningful and may be best characterized as misleading to the members of an institution. Such disclosures are barred by OTS rules.

Freedom of charter choice only has meaning if members are able to exercise an informed choice, which requires sound and reliable information to be provided to members in the context of a proposed charter conversion. It is critical to find the right balance to ensure that disclosures are both meaningful and useful to institution members.

VII. Conclusion

OTS believes in the fundamental precept of charter choice and supports the efforts of financial services providers to be organized under the charter that best supports their business plan and operating strategy. It is important for all regulators to uphold the basic rights of freedom of choice. Regulatory barriers that do not protect consumers and/or institutions, but rather that serve as regulatory obstacles should be eliminated. The integrity of our financial services system requires this.

I want to thank you, Mr. Chairman, Representatives McHenry and Gillmor, and others who have shown leadership on this issue. We look forward to working with the Subcommittee as you continue to work through this important issue.

Take a trip to creditunionland and bring back a credit union

by Rosie Oda, Pillsbury Winthrop Shaw Pittman LLP

Is the credit union industry a source of new business opportunities, core deposits and a loyal customer base for banks? The opportunities are worth pondering.[1]

Credit unions as customers

To obtain necessary services, credit unions rely on large corporate credit unions like WesCorp, which have member credit unions and are chartered as credit unions, but act as correspondent banks. Credit unions buy CDs, mortgage-backed securities, derivatives and other investments and services from corporate credit unions. Credit unions also form their own credit union service organizations. Credit union trade associations have also formed for-profit subsidiaries to provide credit card processing and other services. While some banks do have business relationships with credit unions, the credit union industry has largely created its own sources for wholesale financial services and banks have let that market slip away.

Credit unions as targets of acquisitions and mergers

The same forces that make it difficult to start up a credit union or operate a small credit union may make conversion to, or acquisition by, a bank more attractive. As member-owned organizations, it is difficult for credit unions to be as nimble as banks in implementing new strategies and adjusting to technological advances that require large capital investments. This is because they lack access to capital markets and must rely on retained earnings to grow or to react to market changes.

Total credit union numbers, like bank numbers, are about half of what they were in the 1970s. Moreover, no new state credit union has been chartered in California for nearly two decades. It is overwhelmingly difficult for credit union organizers to find enough interested potential members, to assemble the technology, capital and expertise needed, or to convince a sponsor to donate the required capital investment.

What is happening in the thrift industry may be a mirror for credit unions. In California, where there were once more than 400 state-chartered savings and loans, the state-chartered thrift is extinct. Only 27 thrifts remain in California, all federally chartered. Most S&Ls used to be mutual associations owned by their members and were tax-exempt until 1988. The members of mutuals that converted to stock cashed out or bought stock. The conversion of credit unions is a developing trend: across the country, 29 conversions have occurred, two in California.

There are several ways to accomplish a conversion or its equivalent. One method is for a credit union to convert to a mutual savings association and then, a year later, convert to a stock savings association. Either the Office of the Comptroller of the Currency or the Department of Financial Institutions could use its interpretive powers to permit a direct merger transaction.

In July this year, the National Credit Union Administration approved the novel application of Nationwide Federal Credit Union to merge with Nationwide Bank, a federal thrift subsidiary of the insurance company that sponsored the credit union. The Office of Thrift Supervision is currently deciding whether to treat this transaction as a liquidation and P&A transaction or to approve it as a direct merger of a credit union into a thrift. The important point is that the Nationwide transaction was structured so that the members got more out of the deal than the usual right to buy stock on a *pro rata* basis with the deposit amounts in their member share accounts.

Credit unions often have more retained earnings than capital accounts of banks of similar size. James A. Wilcox, professor at Haas School of Business at the University of California at Berkeley, points out that retained earnings can be tapped by transaction structures similar to that used by

About the author: Rosie Oda from Pillsbury Winthrop Shaw Pittman LLP is a member of a credit union that has 75 volunteers. She serves on its asset management committee with five other volunteers. Oda has spent much of her career as a bank regulator and is currently a director at a de novo bank.

LEGAL *Notes*

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Nationwide Bank, or by demutualization, to release retained earnings and other enterprise value to members.

As fields of membership have grown and the common bond is diluted, credit unions are beginning to lose their distinctive identities, and even some members view them as banks. The tipping point may have arrived where credit union members will be willing to cash in their membership interests, and banks should seize that opportunity. CB

[1] *Professor James A. Wilcox, Haas School of Business, University of California at Berkeley, has written a fascinating book on this subject, published by a credit union think tank, the Filene Research Institute:* Credit Union Conversions to Banks: Facts, Incentives, Issues and Reforms. *Wilcox will be the featured speaker on this subject at a forum sponsored by the Financial Institutions Committee of the California Bar Association Sept. 6 at the Federal Reserve Bank of San Francisco. His book is a source for much of this article.*

The Financial Institutions Committee
of the
California State Bar Association Presents

CREDIT UNION CONVERSIONS TO BANKS

September 8, 2006
Federal Reserve Bank of San Francisco

8:30 – 9:00 Security clearance; registration and refreshments

9:00 – 9:15 Welcome and Introductions
- Gerry Tsai, Assistant General Counsel, Federal Reserve Bank of San Francisco
- John Hancock, Chair, California Bar Financial Institutions Committee (also Vice President, Enterprise Compliance, World Savings Bank)

9:15 – 9:30 Differences between Credit Unions and Banks
- Ron Fong, Director of State Government Affairs, California Credit Union League

9:30 - 10:15 Conversion Issues, Incentives, and Public Policies
- Professor James A. Wilcox, Haas School of Business, University of California at Berkeley

10:15 – 10:30 Break

10:30 – 10:50 Brief comments from other Members of the Panel

- Rosie Oda (Moderator), Pillsbury Winthrop Shaw Pittman LLP
- John E. Bowman, Chief Counsel, Office of Thrift Supervision
- Barrie Graham, a Director, California Bankers Association (also, President and CEO, Exchange Bank)
- Harold T. Hanley, III, Managing Director, Keefe, Bruyette & Woods, Inc.

10:50 - Noon Audience Q&A with full Panel, including Speakers

Ron Fong

Ron Fong, Director of State Government Affairs

Ron joined the California Credit Union League in the spring of 1996. Ron was promoted to Director of State Government Affairs in January, 2005. As Director, Ron is the chief registered lobbyist in both California and Nevada. He is in charge of the Sacramento office and it's staff and the League's outside contract lobbyists. He is primarily responsible for the state legislative agenda at the League. Ron's duties include monitoring and lobbying all legislation that positively or negatively affect credit unions and aggressively pursuing positive legislation for credit unions.

Prior to joining the League, Ron worked at Littler, Mendelson, Fastiff and Tichy, the largest employment law firm in the nation, and also at the Sacramento District Attorneys Office. He holds a Juris Doctorate degree (JD), is a former stock broker and college business law instructor. He gained his finance and business knowledge from five years as president of his family's grocery store chain, which was established in Sacramento in 1941.

Ron holds a Bachelor of Arts degree from California State University, Sacramento and a Juris Doctorate (JD) degree from Golden Gate University in San Francisco.

You may reach Ron at (800)439-2285 or via email at rfong@ccul.org

August 2006

James A. Wilcox

James A. Wilcox is the Kruttschnitt Professor of Financial Institutions at the Haas School of Business at the University of California, Berkeley.

Jim teaches courses on business conditions, on financial markets and institutions, and on risk management at financial institutions. He has won several awards at Berkeley for his teaching. He has also served as Chair of the Finance Group at the Haas School. Jim has published widely on credit unions, banking, housing and mortgage markets, monetary policy, and business conditions. His articles have been published in the *American Economic Review*, *Journal of Housing Economics*, *Journal of Finance*, *Review of Economics and Statistics*, *Journal of Business and Economic Statistics*, *Journal of Money, Credit and Banking*, and elsewhere.

He has recently published research reports for the Filene Research Institute on conversions of credit unions and on credit union failures and losses to the share insurance fund.

From 1999-2001, Jim was the Chief Economist at the Office of the Comptroller of the Currency. Previously, he had served in Washington as the senior economist for monetary policy and macroeconomics for the President's Council of Economic Advisers and as an economist for the Board of Governors of the Federal Reserve System. He has also been a Visiting Scholar at the Federal Reserve Bank of San Francisco and is a Fellow of the Wharton Financial Institutions Center and is a founding Fellow of the Filene Research Institute. Jim received his Ph.D. in economics from Northwestern University.

Jim is a Director and is the Treasurer of Cal State 9 Credit Union, which is headquartered in the San Francisco Bay Area.

Jim's homepage (http://www.haas.berkeley.edu/finance/wilcox.html) provides more information and access to some of his publications.

Presenter Biography

HAROLD T. HANLEY, III

Harold is a managing director in KBW's Columbus office. He joined KBW in January of 1995 after fourteen years as chief financial officer of two savings institutions located in Ohio and Michigan. In this capacity, Harold was involved with an initial public offering, debt offerings, mergers and acquisitions, and deposit and branch sales.

Since joining KBW, Harold has led many thrifts in their mutual-to-stock conversions, primarily in the Midwest and Southern states. Additionally, he has managed merger and acquisition transactions of thrifts and community banks, and provided financial consulting services to clients in conjunction with their conversion and merger and acquisition process. Harold has been a speaker at American Community Bankers conferences, Financial Managers Society conferences and various state meetings.

Prior to entering the financial services industry, Harold was with the Toledo, Ohio office of KPMG Peat Marwick & Co. for several years. Harold is a registered representative and a Certified Public Accountant. While in the financial services industry, Harold was active in the Financial Managers Society, including serving on the national Board of Directors. Harold earned his Bachelor of Business Administration degree from The University of Toledo in 1975 and obtained his CPA license in 1976.

Office of Thrift Supervision

FOR RELEASE at 11:00 A.M. EDT

Tuesday, April 20, 2004

OTS 04-11

For further information

Contact: Chris Smith

202/906-6677

OTS CHIEF COUNSEL CAROLYN BUCK ANNOUNCES RETIREMENT; JOHN BOWMAN NAMED AS SUCCESSOR

WASHINGTON – Carolyn J. Buck announced today her intention to retire from the Office of Thrift Supervision (OTS) effective May 29, 2004, after over 30 years of government service, including the past 11 years as Chief Counsel of OTS. In this position, Buck has management responsibility for the legal staff at OTS, including those in the four OTS regions.

She joined OTS in June 1990 from the Department of Housing and Urban Development, where she had served in various management and staff positions in HUD's general counsel's office since 1971. After joining OTS, Buck served successively as Senior Deputy Chief Counsel of Litigation and Enforcement and Acting Chief Counsel before being named Chief Counsel in November 1994.

Buck received a bachelor's degree from the University of Minnesota and her juris doctor degree with honors from George Washington University.

OTS Deputy Director Rick Riccobono said that, "Carolyn has helped OTS meet the extraordinary challenges we've faced this past decade with her exceptional legal skills, good humor, and effective leadership."

John E. Bowman has been named to serve as Chief Counsel for OTS effective with Buck's departure.

Bowman joined OTS in June 1999 as Deputy Chief Counsel for Business Transactions, heading the agency's division that provides legal services related to corporate applications, acquisitions and financing transactions, securities filings, mutual-to-stock conversions and other related activities. He also oversees OTS's regional counsel and enforcement operations.

Immediately prior to joining OTS, he was partner with the law firm of Brown & Wood LLP in Washington, DC, specializing in government and corporate finance, securities and financial services regulation. Before entering private practice, he served for 14 years at the U.S. Department of the Treasury, including seven years as the Assistant General Counsel for Banking and Finance. He provided counsel on a broad range of issues — ranging from financial modernization legislation to financing the Federal debt — to the Under Secretary for Domestic Finance; the Assistant Secretaries for Financial Institutions Policy, Financial Markets and Economic Policy; and the Fiscal Assistant Secretary.

Earlier, he served as a senior attorney in the Office of the General Counsel at the U.S. Department of Agriculture, working on a variety of issues related to government, corporate, energy and public utility financing.

He received a bachelor's degree from the University of California and a juris doctor from Pepperdine University School of Law.

During his government career, he has been the recipient of numerous awards and honors including the Presidential Rank Award and the Secretary of the Treasury's Distinguished Service Award.

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The Office of Thrift Supervision (OTS), a bureau of the U.S. Treasury, regulates and supervises the nation's thrift industry. OTS's mission is to ensure the safety and soundness of thrift institutions and to support their role as home mortgage lenders and providers of other community credit and financial services. For copies of news releases or other documents visit the OTS web page at www.ots.treas.gov.

J. Barrie Graham
President & Chief Executive Officer

Exchange Bank
P.O. Box 403
Santa Rosa, CA 95402
707-524-3105 707-579-4745 (fax)
grahamb@exchangebank.com

EXCHANGE BANK, SANTA ROSA, CALIFORNIA

Barrie Graham was named President and CEO of Exchange Bank in January, 2003. Barrie joined Exchange Bank in 1995 and served as Executive Vice President and Chief Operating Officer prior to his appointment as President/CEO. Exchange Bank, founded in 1890, is an independent community bank headquartered in Santa Rosa (50 miles north of the Golden Gate Bridge) with $1.4b in assets, 450 employees, and 20 branches. Exchange Bank has long been considered one of the premier community banks in California, based upon its commitment to customer service, community involvement, and consistently excellent financial performance. The Bank's co-founder, Frank Doyle left his controlling interest of 51% to a perpetual trust upon his death in 1948. This unique ownership prevents the Bank from being bought, sold or merged, and the dividends from the trust are given to the Santa Rosa Junior College for scholarships. More than $72 million in scholarships have been awarded to over 100,000 students since 1948.

PREVIOUS BANK EXPERIENCE

1985-1995, Wells Fargo Bank, San Francisco. Senior Vice President & Manager. Responsible for business development for the Commercial Banking Group.

EDUCATIONAL BACKGROUND

B.S., Industrial Engineering, Clarkson College of Technology
Executive Management Program, Harvard Graduate School of Business
MBA, Golden Gate University
Graduate, Pacific Coast Banking School, University of Washington

COMMUNITY INVOLVEMENT

Board Member-Empire College, Canine Companions for Independence; Main Street-Downtown Santa Rosa Redevelopment; Investment Advisory Committee-Community Foundation Sonoma County; California Bankers Association; Pacific Coast Banking School

MILITARY

1969-1974 Infantry Officer, United States Marine Corps

Pillsbury
Winthrop
Shaw
Pittman LLP

San Francisco
50 Fremont Street
San Francisco, CA 94105-2228
Ph: +1.415.983.1048
Fax: +1.415.983.1200

Practices

Corporate & Securities

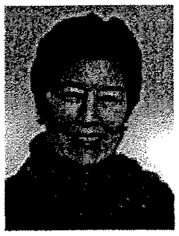
Finance

Financial Services Regulation

Industries

Consumer & Retail

Professionals > Rosemarie Oda



Rosemarie Oda
Counsel
rosie.oda@pillsburylaw.com

Ms. Oda brings a vast wealth of knowledge in federal and state banking regulation to the firm, and has the unique distinction of having held high-ranking positions at both a federal bank regulatory agency and a state banking department. For three years, Ms. Oda was the General Counsel of the Department of Financial Institutions for the State of California (DFI). In that capacity, her work included regulating state-chartered banks, trust companies, savings and loan associations, industrial banks, credit unions, transmitters of money abroad, payment instrument companies, and insurance premium finance companies. Ms. Oda implemented the Internet Legal Precedent System, which simplified the process for DFI staff and licensees to access past interpretations and opinions. She was also instrumental in completing long-standing pending liquidations, and providing counsel and advice on multiple legal issues, legislation and regulation.

Prior to this position, Ms. Oda was the District Counsel for the Western District Office of the Comptroller of the Currency (OCC), the agency which regulates national banks, for nearly five years. Until recently, the Western District Office was located in San Francisco and covered 13 states. She worked for the OCC for a total of 17 years, including nine in its Washington, DC headquarters, in the Enforcement and Compliance, Legal Advisory and Legislative and Regulatory Analysis divisions.

At the firm, Ms. Oda has worked on the merger of an S&L, three bank mergers, two bank holding company acquisitions of banks, closings of a foreign bank agency and a foreign bank branch, an application for a foreign bank branch, the impact of the SEC's Proposed Regulation B on bank wholesale activities, conversion of a member bank to nonmember status, advised a credit card bank, and reviewed the potential acquisition of a trust company. She has also worked on issues involving: bank insurance activities, BOLI, anti-money laundering, privacy, finance lender licensing and legal issues, federal credit union law, acquisition of a transmitter of money abroad, HMDA and other consumer laws, letters of credit, foreign bank securities activities, and the formation of two new internet companies, one of which is an internet finance lender. She has participated in an investigation of fraudulent credit cards for a credit union and has worked on a project for a bank involving electricity derivatives. For retailers, she has worked on stored value card issues, fraudulent use of credit cards, and tape recording of telemarketing calls. She has also worked on public utility regulatory issues.

Ms. Oda was the Chair of the San Francisco Bank Attorneys Association for 2004. She is Secretary of the California Bar Association Financial Institutions Committee of the Business Law Section. She spoke at the last California Bankers Association Regulatory Compliance Seminar and at a meeting of the San Francisco Bank Attorneys Association. She serves on the California Bankers Association Task Force on Corporate Governance and helped produce an acclaimed survey on corporate governance. In 2004, she spoke on Preemption at the American Bar Association Joint Business Law Section Spring Meeting and CBA Bank Counsel Seminar. In 2005, she also spoke on Industrial Banks at the American Bar Association meeting of the Banking Law Committee. This year, she joined the faculty of the American Bar Association Basic Banking Law Seminar, which is held twice a year, where she speaks on the Dual Banking System. Ms. Oda serves on the Asset Management Committee of Chevron Federal Credit Union and is a director of NewResources Bank (in organization), to be located in San Francisco.

Education

J.D., University of California, Los Angeles

B.A., University of California, Berkeley

Certificate in Banking, Pacific Coast Banking School, University of Washington, 1987

Affiliations

Admitted to practice: State of California, District of Columbia

Member of: San Francisco Bank Attorneys Association (Chair, 2004); American Bar Association; Asian American Bar Association; Financial Women's Association; OCC Alumni Association

The Credit Union Difference

Ron Fong

Director of State Government Affairs

Presented to

The Financial Institutions Committee

State Bar of California

Credit Unions in California & Nevada
(June 2006)

	California	Nevada
CUs	548 (450)	29 (25)
Members	9.9 million	.5 million
Assets	$113 billion	$4.8 billion

Dual Chartering System
State and Federal Credit Unions

- STATE CHARTERS
  - Regulated by DFI
  - State legislature passes laws to regulate
  - If federally-insured, also subject to NCUA jurisdiction (e.g., capital requirements, business lending)
- FED CHARTERS
  - Regulated by NCUA
  - Congress passes laws to regulate
  - Not subject to most state banking laws

Non Profit Cooperatives

- Tax Code 501 (c)
- Volunteer Board of Directors
- One member, one vote in elections
- No shareholders, just members
- Not subject to State or Federal business, banking, or corporate taxes
- Do not retain profits, return them to member owners
- FCUs: 501(c)(1)
- State CUs: 501(c)(14)

Tax Exemption
Federal and State Credit Unions

- STATE CHARTERS IN CALIFORNIA
  - Pay No Franchise Tax
  - Pay Sales and Use Tax
  - Pay Real Property Tax
  - Pay Local Utility User Tax
  - Pay Payroll Tax
  - Pay Unemployment Tax

- FEDERAL CHARTERS IN CA
  - Pay No Sales Tax
  - Pay No Franchise Tax
  - Pay Real and Personal Property Tax
  - Pay Payroll Tax
  - Pay Unemployment Tax

Limited Customer Base (aka "Fields of Membership")

- Original fields of membership were by community
- Shifted to common employment or association
- Today, community charters popular again
- Conversion from employment based to community due to economic shifts

Other Restrictions Faced by Credit Unions

- Business Lending/Loan Participations
  - Cap of 12.25% of credit union assets
- Investments
  - Limited authority to invest in securities
  - Prohibited from investing in community development corporations (CDCs) or community development loan funds (CDLFs)
- Underserved Areas

Credit Union Service Organizations CUSOs

- For profit companies
- Subsidiaries of credit unions
- CUSOs taxed as independent businesses
- Profits may flow back to parent credit union
- Wide variety of business activities
  - Insurance
  - Investment services
  - Auto brokers
  - Technology/processing services
  - Mortgage loans

Raising Capital

- CREDIT UNIONS
  - Interest on mortgage, auto, personal and limited small business loans
  - Investments
  - Fees
  - CUSOs
- BANKS
  - Customer fees
  - Non-customer fees
  - Stock market
  - Major capital investments
  - Business lending
  - Securities
  - Insurance
  - Affiliated Companies

CU System Collaboration & Innovation

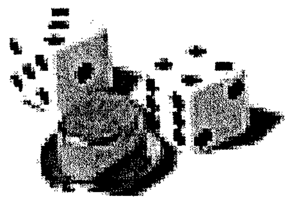
- No-Fee ATM Network
  - CO-OP Network: 25,000 ATMs
    - Including >5,000 7-Eleven stores
- Shared Branch Network
  - Member access to CU away from home.
  - Evacuees from Katrina accessed funds via CU shared branch system.

CU SERVICE CENTERS®
The Member Friendly Financial Network

California Credit Union League

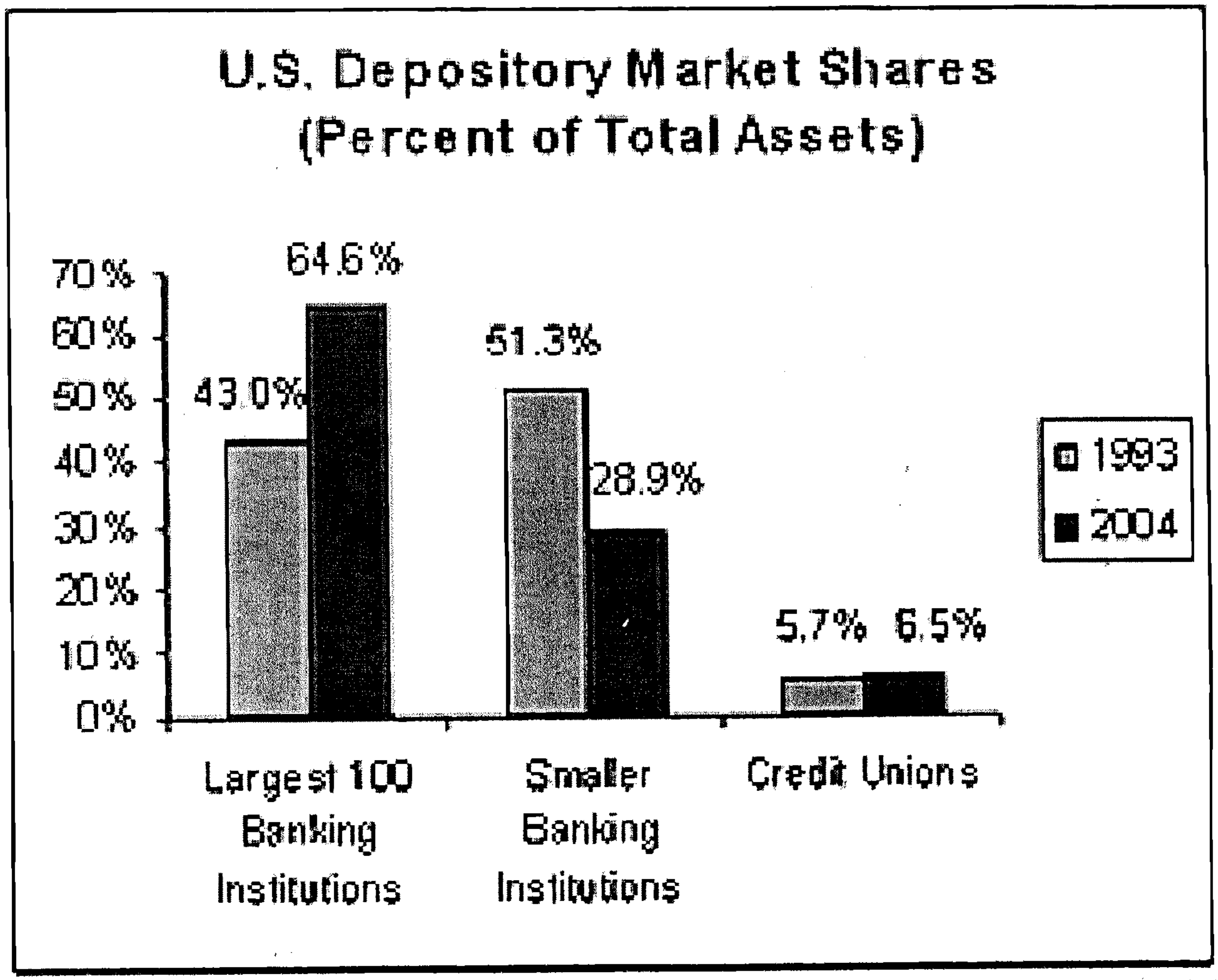
NEVADA

CREDIT UNIONS



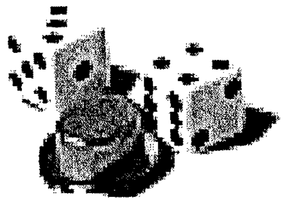
Get The Facts!
THIS IS NOT A GAME

(Source: FDIC)



California Credit Union League

America's Credit Unions



Get The Facts!
THIS IS NOT A GAME

People of modest means use credit unions.

Source: Filene Research Institute

- Average Income of Households Using Banks Only:

  $76,923

- Average Income of Households Using CUs Only

  $42,664

California Credit Union League

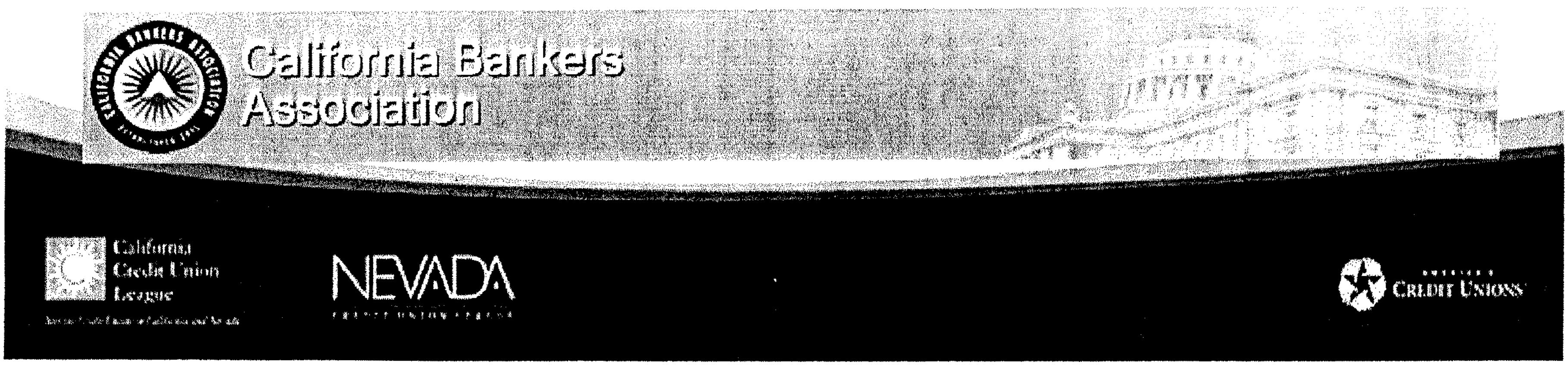
NEVADA

CREDIT UNIONS

US Bankers' Coordinated Effort against US CUs

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

America's
Community
Bankers
Shaping Our Future



Beat credit unions at their own game.

OPERATION CREDIT UNIONS

CA 2003 Legislative Session-AB 1226 (Montanez)
-Bill to tax credit unions and regulate CRA

Credit Union Conversions: Issues, Incentives, and Public Policies

James A. Wilcox

Haas School of Business
University of California, Berkeley

(510) 642-2455
jwilcox@haas.berkeley.edu
http://haas.berkeley.edu/finance/wilcox.html

Outline

- Steps to conversions
- Issues and incentives in conversions
- Reforms for conversion policies
- Demutualization
- Acquisition (via merger)

Differences Between Credit Unions and Banks

- Cooperative or mutual vs. stock ownership
- Directors' and managers' compensation
- Income taxes
  - Over 2,200 banks are subchapter S corporations
- Fields of membership vs. branching restrictions
- Limits on lending and investment activities
- Abilities to raise capital
  - Retained earnings, subordinated debt, TPS, and stock

Steps to Conversions: From Credit Unions to Mutual Banks

- Before 1998
  - Wide latitude for NCUA to restrict conversions
  - NCUA required 50% of <u>all</u> members vote "yes"
- After 1998 (CUMAA, a.k.a. HR1151)
  - Law requires 50% of <u>voting</u> members vote "yes"
    - Some details on voting are in the Appendix
  - NCUA may only "monitor" voting process
    - Of conversions of credit unions into mutual thrifts
  - NCUA can be no more onerous than OTS/FDIC

Steps to Conversions: From Credit Unions to Mutual Banks

- Growing body of NCUA regulations monitor conversion voting process
- Disclosures
  - Changes in voting rights
  - Compensated directors
  - Income taxes
  - Subsequent stock conversion is possible
    - Voting rights could be lost by members if they do not buy stock
  - Costs of conversion itemized
    - Printing, postage, advertising, consultants, lawyers, special meeting, voting
  - Announce intentions regarding
    - Subsequent stock conversions
    - Benefits to directors and managers
    - Voting rights
- Voting conducted by independent entity with experience in corporate elections
- Restrictions on compensation for conversion
- State-chartered credit unions inform NCUA of their state conversion rules

Steps to Conversions: From Mutual to Stock Banks

- A vote of the depositors is required
- Shares of stock issued in amount similar to existing net worth
  - Possibility of "overcapitalization"
- Share subscription rights give option to depositors
  - Depositors have option to buy shares pro rata to their recent deposits
  - Few depositors have exercised these options
    - "5% solution"
- Amount of shares purchased by directors and managers capped
- Remaining shares sold in initial public offering (IPO)
  - Ownership of newly-raised capital assigned to all buyers of shares
  - Ownership of "old" capital also assigned to all buyers of shares
    - Share prices reflect this reassignment with "first day pops"
- Many mutuals convert to stock via MHCs
  - Sell minority stake in the (stock) bank and MHC retains majority control
  - Often, "second-step" conversion converts to entirely stock ownership

Steps to Conversions: From Mutual to Stock Banks

De novo stock bank @ IPO

IPO cash	6	New capital	6

Return on new capital = 0.06/6 = 1%
Return on equity = 0.06/6 = 1%

Stock bank after growth

IPO cash	6	New deposits	94
New assets	94	New capital	6

Return on new capital = 1/6= 16.67%
Return on equity = 1/6= 16.67%

Converting bank @ IPO

Old assets	100	Old deposits	94
IPO cash	6	Old capital	6
		New capital	6

ROA Assumption = 1.00%
Return on new capital = 1.06/6= 17.67%
"Return on equity" = 1.06/12= 8.83%

Converted bank after IPO and growth

Old assets	100	Old deposits	94
IPO cash	6	New deposits	94
New assets	94	Old capital	6
		New capital	6

Return on new capital = 2/6= 33.33%
"Return on equity" = 2/12= 16.67%

Issues and Incentives in Conversions: Who Gets the "Old" Capital?

Former credit unions	Conversion date	IPO date	1st day pop (%)
AWANE	5/1/96	6/29/04	3.8
BUCS	3/1/98	3/15/01	30.0
Synergy	5/1/98	9/18/02 1/21/04	29.3 9.0
Affiliated	6/1/98	6/1/01	7.5
Ohio Central	6/1/98	3/31/05	20.0
IGA	7/1/98	10/5/99	8.6
Kaiser Permanente	11/1/99	3/31/04	34.9
Pacific Trust	1/1/00	8/23/02	18.6
Atlantic Coast	11/1/00	10/5/04	17.5
Rainier Pacific	1/1/01	10/21/03	69.9
AGE	7/1/01	7/5/05	7.5
Allied Pilots Association	9/1/01	12/31/01	19.0
Citizens Community	12/12/01	3/30/04	23.7
Median	-	-	**19.0**

Issues and Incentives in Conversions: Voting and Governance

- Credit unions and mutual banks
  - Customers are owners
  - Fiduciary duty to customer-owners
- Stock banks
  - Customers are not owners
  - Fiduciary duty to non-customer owners

Issues and Incentives in Conversions: Voting and Governance

- Saver-dominated vs. borrower-dominated benefits
- One member, one vote vs. proportional voting
  - What is "fair"?
- In practice, who votes?
  - Participation may be weak
- Are credit unions managed in interests of members or managers?
- Are credit unions managed efficiently enough?

Issues and Incentives in Conversions: Why Convert?

- To raise capital
- To remove limits on size and activities
  - No fields of membership
  - Fewer limits on activities
- To pay managers and directors with shares
- To acquire old (or "orphaned") capital
  - Provide a home with "adopting" members
    - Depositors buy few shares
    - Managers and directors purchase lots of shares

Continuing and Converting Benefits to Credit Union Members

- Continuing Benefits
  - Advantageous loan and share interest rates
  - Better customer service per dollar of fees
- Converting Benefits
  - Benefits of operating as mutual bank
  - Conversion capitalizes capital
    - More capital, more incentive and reward to conversion
  - Converts institution's value into realizable assets
    - Via cash or tradable shares of stock

Potential Reforms: Change Legislation

- Outlaw conversions
  - Some states prohibit state CU conversions
- Change voting rules
  - Require 50% of all members (not just of voters)
    - Some states require approval of 2/3 of voting members
  - Require 20% of members to vote
    - Proposed in proposed CURIA legislation

Potential Reforms: Change Regulatory Stance

- Enforce existing regulations more strictly
  - Columbia Credit Union
    - How many members does an account have?
  - Texas mega credit unions
    - Was it misfolding, misleading, miscommunication, mistaken?
  - Beginnings of legislative backlash?
- Throw in more regulatory roadblocks
  - Require more disclosures and voting regulations
    - Push up costs and reduce feasibility of conversion
  - But, CUMAA requires parity with thrift conversions

Potential Reforms: Allow Demutualization

- Members get shares of stock (not options on shares)
  - Numbers of shares pro-rated by member deposits
- Similar to demutualizations in
  - US mutual insurance companies
  - UK building societies
- May former credit unions demutualize now?
  - “No” – OTS does not permit banks to demutualize
    - Banks must follow standard, first, or second stage conversions
    - This requires them to reassign old capital to new owners!
    - And, NCUA cannot tell OTS how mutual banks should convert

Potential Reforms: Allow Demutualization

- No law or NCUA regulation prohibits it!
  - Convert a credit union directly into a commercial bank
    - Possible under the pre-CUMAA provisions that are still in the law
    - Subject to NCUA authorization
- Ongoing proposals
  - Massachusetts Senate Bill 662
    - Demutualization for mutual banks
  - Former NCUA Chairman Ed Callahan on June 7, 2004
    - Advocated cash out options for dissenting CU members
  - NCUA Chairman JoAnn Johnson on June 10, 2005
    - Asked Congress to consider CU demutualization

Potential Reforms: Allow Demutualization

- NCUA regulations could preserve members' capital
  - Recognize greater contributions of long-time members
    - Assign shares by history of deposits (and loans)
  - Distribute only shares of stock
    - Not cash
  - Distribute shares of stock gradually
    - Markets reveal value to members
  - Direct repurchase programs
    - Reduces transactions fees for small savers
  - Permit simultaneous IPOs to raise additional capital
- Option to demutualize alters incentives to convert
  - Can reduce management and outside investors' incentives to convert
  - Can raise members' incentives to convert

Acquisition (Via Merger)

- One "merger" is under way with NCUA approval
- Nationwide FCU is the target
  - $525MM assets, $63MM in (book value of) net worth, 12% capital ratio, and 44,000 members/customers
- Nationwide Bank is the acquirer
  - A deposit and lending *de novo* subsidiary of insurer Nationwide
- Members get $79MM cash for $63MM in net worth
  - *Pro rata* to deposits as of March 31, 2006
    - $150 in cash for each $1,000 in deposits
- Initially, deposits and loans are unaffected

de novo and Mature Banks

de novo Bank

Assets		Liabilities	
Cash	8	Capital	8

Mature Bank

Assets		Liabilities	
Assets	100	Deposits	92
		Capital	8

- *de novo* banks typically incur losses for their first few years of operation
    - Start-up costs and initial losses could cost 10 percent of initial capital raised
- *de novo* banks require 5-10 years to achieve industry-average ROAs

Avoiding Growing Pains by Merging with a Credit Union

de novo Bank

Cash	8	Capital	8

Mature Credit Union

Assets	100	Deposits	92
		Capital	8

- CU members get cash
  - Capitalized value of their CU
- Bank gets core deposits, loans, facilities, organization
- Bank immediately earns ROA of an ongoing operation, e.g., 100 bp's
- Did I mention core deposits?

de novo, Mature Bank

Assets	100	Deposits	92
		Capital	8

Summary I:
Suddenly, Serious Options

- Remain a credit union
  - Members receive ongoing benefits
- Liquidate the credit union
  - Destroying going-concern value is likely the worst option
- Standard conversion
  - Those who bought stock averaged 19% first-day "pops"
  - Management and outsiders bought, but few members have
- Demutualization
  - All members get shares of stock, pro-rated somehow
- Acquisition (via merger)
  - All members get cash, pro-rated somehow

Summary II: Suddenly, Serious Options

- Feasible, sensible options for re-structuring
  - Increases pressure on credit unions to improve performance and efficiency
- Options can be arranged for management
  - Often come into play in bank mergers
    - Used to get right structure, retention, risk-taking, effort
  - Also useful for CU conversions and mergers

Are There Conversion Candidates?
(CA CUs with $100MM-$1B in Assets)

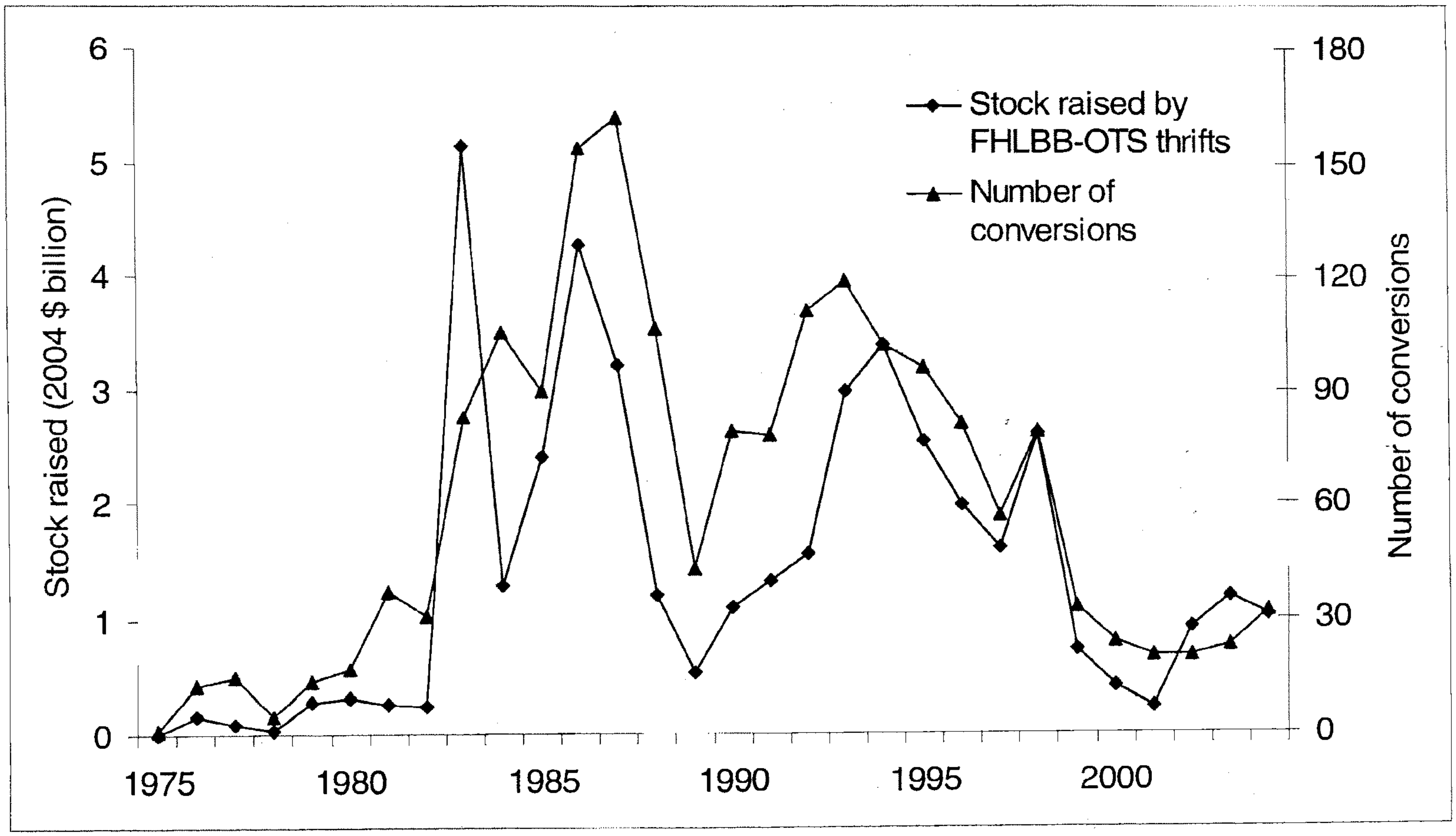
		Net interest margin (NIM) per assets (%)	
		> average of 3.3%	< average of 3.3%
Net worth per assets (%)	> avg. of 10.5	25 CUs Higher capital + Lower benefits → **Conversion candidates**	32 CUs Higher capital, but higher benefits
	< avg. of 10.5	55 CUs Lower capital, but lower benefits	27 CUs Lower capital + Higher benefits → **Not candidates**

Are There Acquisition Candidates?
(CA CUs with $100MM-$1B in Assets)

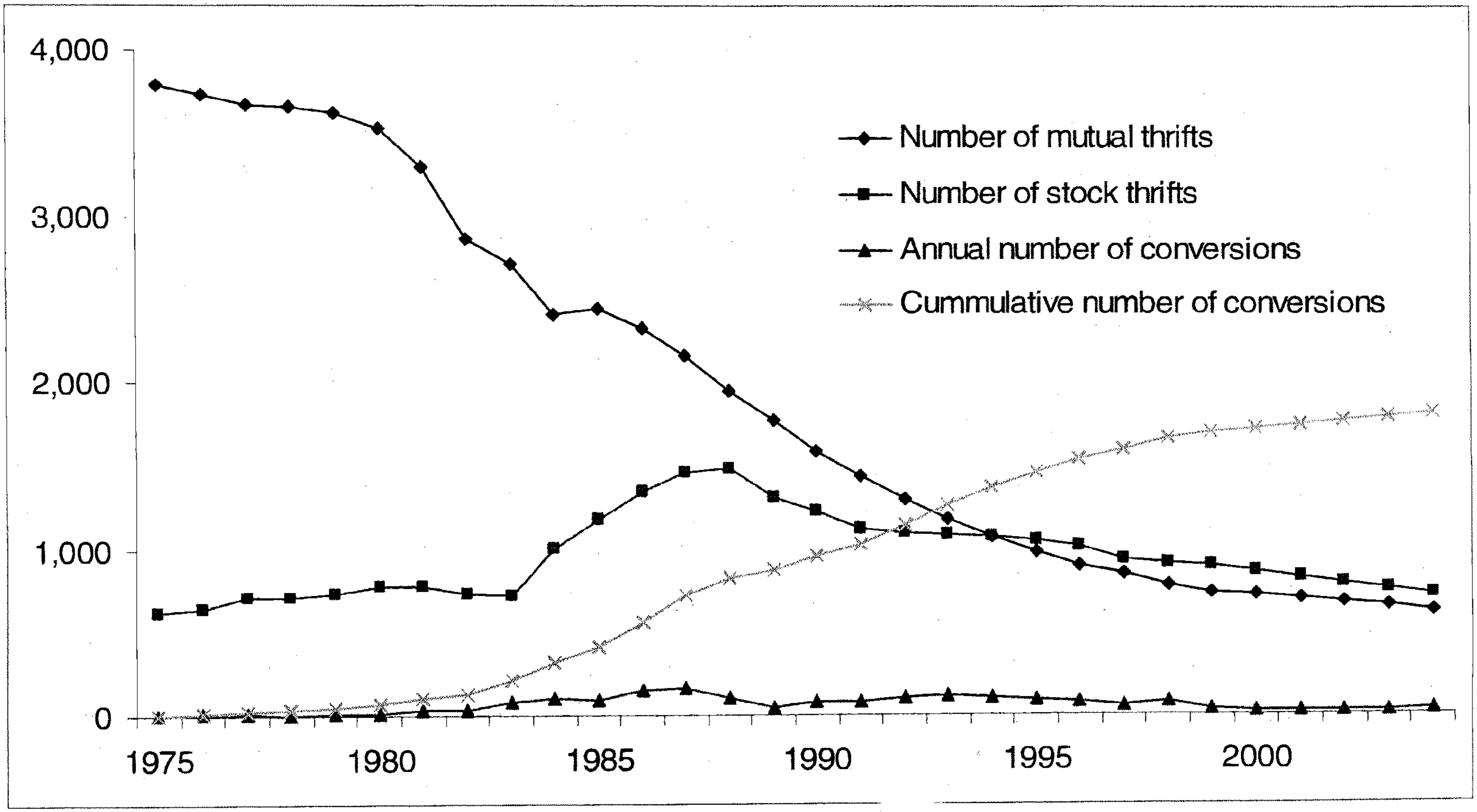
		Noninterest expenses per assets (%)	
		> average of 3.25%	< average of 3.25%
Core deposits per assets (%)	> avg. of 54%	53 CUs Higher expenses + Lots of core deposits → **Acquisition candidates**	20 CUs Lower expenses, but lots of core deposits
	< avg. of 54%	32 CUs Higher expenses, but few core deposits	33 CUs Lower expenses + Few core deposits → **Not candidates**

Appendix:
Some Data on Conversions

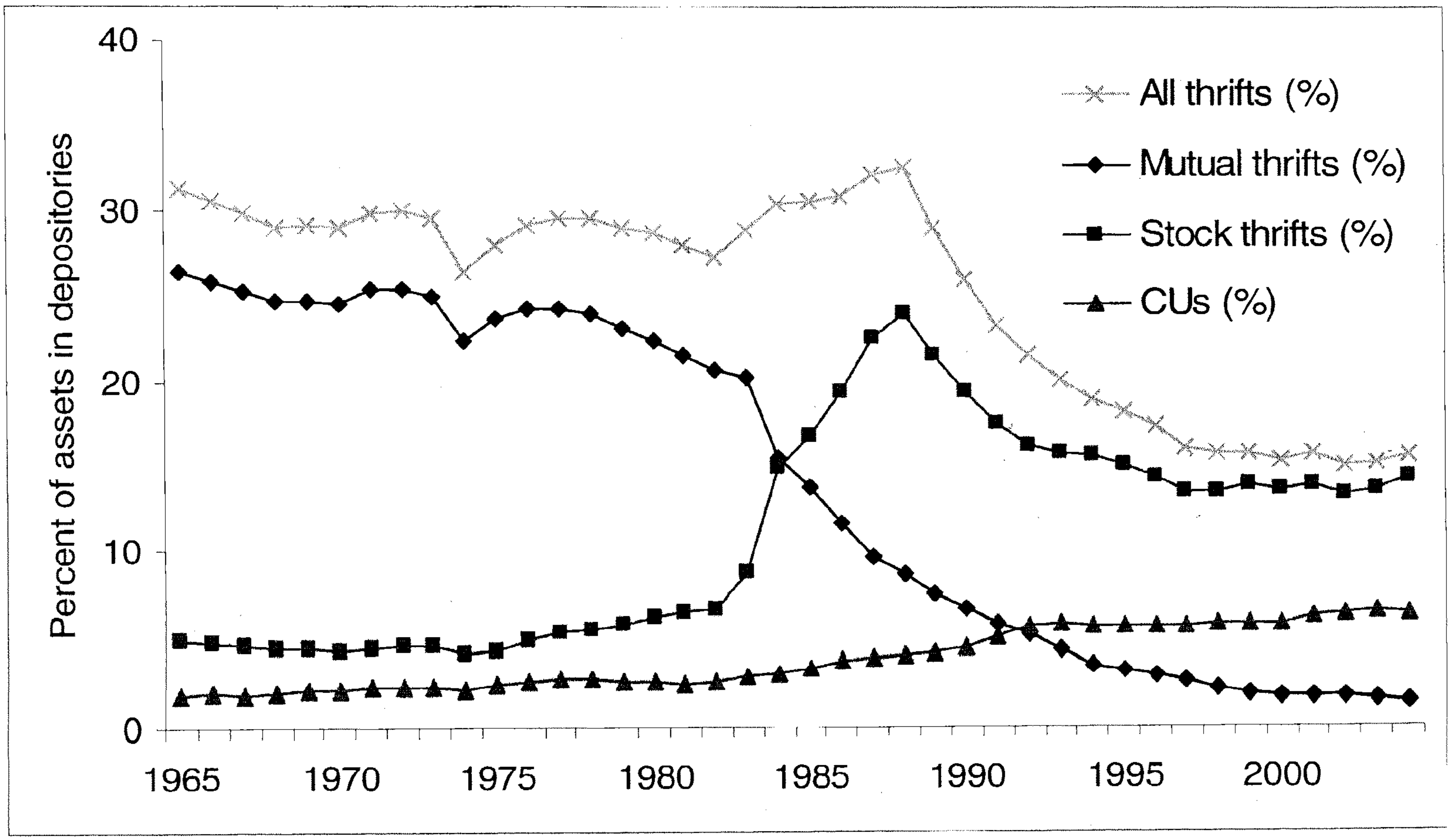
Mutual-to-Stock Bank Conversions



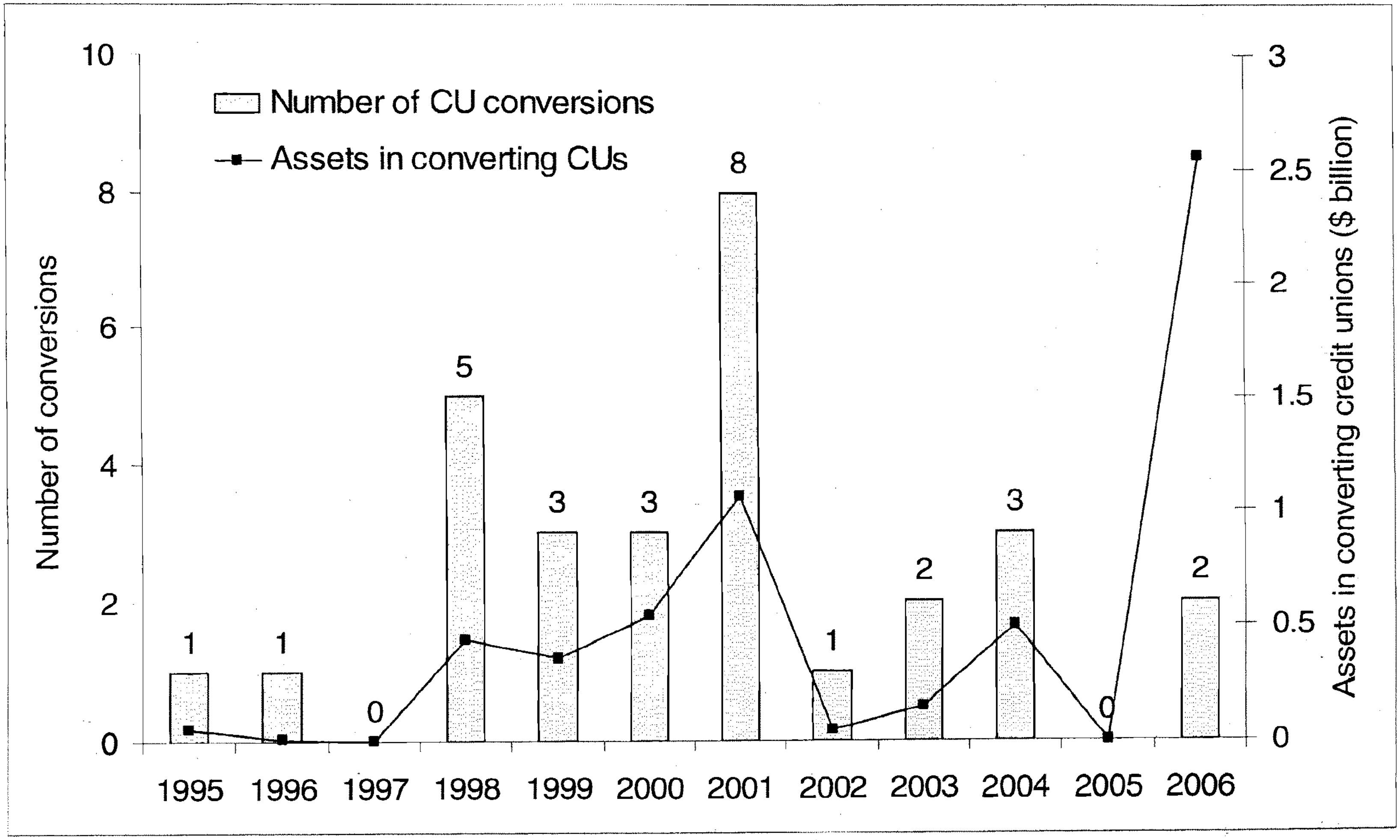
Fewer Mutual and Stock Thrifts: Conversions and Consolidations



Credit Unions: Gaining Market Share From Thrifts



CU Conversions Were Few and Small



Comparison of Converting to Non-converting Credit Unions

	Converting FICUs 1995-2004			Surviving FICUs 1995-2004		
	All	$100m-1b	$10-100m	All	$100m-1b	$10-100m
Number converting	27	13	9	-	-	-
Credit unions	-	-	-	9,014	1,057	3,605
Size	118	209	46.0	44.0	262	32.5
4-year growth	7.66	7.65	8.13	8.27	8.87	3.84
Net worth	10.3	10.1	10.6	10.8	10.7	11.4
Net loans	75.9	77.6	68.4	63.3	64.0	62.8
MBL	4.83	5.15	3.26	0.91	1.21	0.58
Real estate	39.8	41.1	32.7	24.4	26.2	19.2
ROA	0.94	0.87	1.39	0.99	1.01	0.88
Interest income	7.20	7.28	6.85	6.54	6.52	6.86
Interest expense	3.19	3.25	2.93	2.96	2.93	2.90
Noninterest exp.	3.68	3.64	3.90	3.15	3.20	3.58
Charge offs	0.40	0.40	0.40	0.30	0.31	0.30

Voting Rules

- Credit union to mutual bank (MB)
  - One member, one vote
  - Requires "yes" votes by over 50 percent of votes cast (federal)
    - Some states require 2/3 of voting members for SCUs
    - Some states do not permit such conversions for SCUs
- MB to MHC or stock bank (SB) and MHC to SB
  - One vote per $100 in deposits
    - But, number of votes must be capped at 1 to 1000
      - In practice, this may mean one member, one vote
      - Or, may introduce some degree of proportionality
    - Some ancient charters grant votes to borrowers
  - Requires "yes" by over 50 percent of votes eligible to be cast
    - Not of count of members, not of votes cast
    - Requires many more "yes" votes to convert

Discussion Materials for:

The Financial Institutions Committee of the California State Bar Association

September 8, 2006

Harold T. Hanley
Managing Director
hhanley@kbw.com
614.766.8401

KBW

Overview of KBW

Firm Overview

Full-service investment bank specializing in the financial services industry

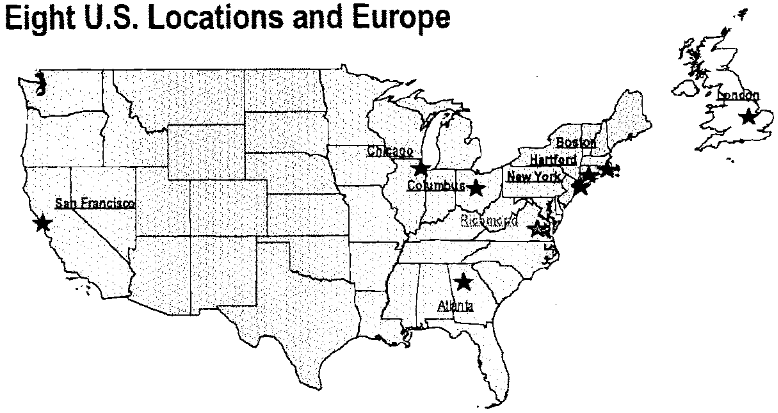
Founded in 1962

441 employees

Independent – no conflicts

$266 million in capital - employee owned

Eight U.S. Locations and Europe



Industry Segments

Depositories (Banks and Thrifts)

Insurance

Diversified Financial Services

- ***Specialty Finance***
- ***Financial Processing & Technology***
- ***Securities & Asset Management***

Business Lines

Investment Banking

Mutual to Stock Conversions; Capital Markets; M&A Advisory

Structured Finance; Private Equity Advisory

Sales and Trading

Equity and Fixed Income

Loan Portfolio Brokerage

Research

Equity and Fixed Income

Asset Management

KBW

KBW: The Industry Leader

Capital Raising

- Pioneer and market leader in pooled trust preferred securities
- #1 ranked manager of mutual conversions by number of transactions 5 of the last 7 years
- #1 ranked lead manager of common stock offerings for banks and thrifts in the past two years by number of transactions

Sales / Trading

- Ranked #1 by institutional investors for equity sales
- In-depth knowledge of financial institution industry
- Over 60 professionals in sales and trading equity group
- #5 ranked market maker in financial services stocks

Research

- Recognized as "Best of the Boutiques" by Institutional Investor again in 2005
- Provides research coverage on more financial services companies than any other firm

Mergers & Acquisitions

- #1 advisor to U.S. financial institutions for the past five years by number of transactions
- Since 1997, advised on 366 transactions totaling nearly $122 billion in value

KBW's Investment Banking Practice: A Client Driven Focus

The basis of our client relationships is a dedication to creating long-term value.

Advisory
- M&A advisory
- Business Line Divestitures
- Takeover defenses
- Valuations & fairness opinions

Debt Capital Markets
- Senior and Subordinated Debt
- Pooled Trust Preferred Securities
- Trust Preferred Securities
- REIT Preferred Securities
- Structured Finance

Equity Capital Markets
- Initial and Follow-on Offerings
- Preferred Stock
- Mutual to Stock Conversions
- Convertibles
- Private Placements

Balance Sheet Strategies
- Securities portfolio analysis
- Share buybacks
- Loan portfolio brokerage (LPSG)

1996 - YTD Conversion Summary

KBW Conversion Rankings

Year	# of Deals	Rank	Total $ of Deals ($ in 000s)	Rank
YTD*	4	1	$99,275	3
2005	8	2	$443,235	4
2004	13	1	$477,674	2
2003	4	1	$226,059	3
2002	5	1	$208,280	3
2001	4	2	$65,078	3
2000	5	1	$45,423	3
1999	8	1	$745,707	1
1998	12	2	$539,831	4
1997	11	2	$739,757	1
1996	18	2	$320,347	3

Source: SNL Securities, LC
*As of 8/25/2006

Recent Mutual to Stock Conversion History

63 Transactions Completed Totaling $2.0 Billion in Gross Proceeds
3 Transactions Pending

Mutual to Stock Conversions (18)

Institution	State	Date Completed	Offering Size ($000)
Alaska Pacific Bancshares, Inc.	AK	7/1/1999	$6,554
EverTrust Financial Group, Inc.	WA	9/30/1999	$85,963
JADE Financial Corp.	PA	10/4/1999	$14,500
MutualFirst Financial, Inc.	IN	12/30/1999	$55,958
Security Financial Bancorp, Inc.	IN	1/5/2000	$19,385
Peoples Community Bancorp, Inc.	OH	3/29/2000	$11,900
CBCT Bancshares, Inc.	TX	9/25/2000	$2,810
Lawrence Financial Holdings, Inc.	OH	12/29/2000	$7,758
BancAffiliated, Inc.	TX	5/25/2001	$2,645
Clover Leaf Financial Corp.	IL	12/28/2001	$6,613
Allied First Bancorp, Inc.	IL	12/28/2001	$6,084
Heritage Bancshares, Inc.	TX	2/28/2002	$4,914
First PacTrust Bancorp, Inc.	CA	8/23/2002	$63,480
Monarch Community Bancorp, Inc.	MI	8/30/2002	$23,144
Community First Bancorp, Inc.	KY	6/27/2003	$2,777
Rainier Pacific Financial Group	WA	10/21/2003	$79,350
Third Century Bancorp	IN	6/29/2004	$16,531
OC Financial Inc.	OH	3/31/2005	$5,602
			$415,968

Proxy Solicitation - No Stock MHC (18)

Institution	State	Completed	
Seneca Falls Savings Bank	NY	4/1/2000	----
Terre Haute Savings Bank	IN	7/1/2000	----
FFS&LA of Edwardsville	IL	12/1/2000	----
Ohio Central Savings	OH	9/21/2001	----
Mutual FS & LA of Chicago	IL	10/1/2001	----
West Bend SB	WI	10/16/2001	----
Heritage Bank of the South	GA	1/31/2002	----
First Savings Bank of Renton	WA	8/23/2002	----
Territorial Savings	HI	9/18/2002	----
Atlantic Coast Federal	GA	10/30/2002	----
Kaiser Federal	CA	6/1/2003	----
Scottsburg Building & Loan	IN	10/7/2003	----
Millington Savings Bank	NJ	12/8/2003	----
United Co-Operative Bank	MA	3/24/2004	----
Beneficial Mutual Savings Bank	PA	8/20/2004	----
Main Street Savings Bank	MI	10/25/2004	----
Hoyne Savings Bank	IL	2/9/2005	----
National Grange Mutual Insurance	FL	8/26/2005	----

First Step MHC Conversions (20)

Institution	State	Date Completed	Offering Size ($000)
Capitol Federal Financial	KS	4/1/1999	$378,072
Alamagordo Financial Corporation	NM	5/15/2000	$3,570
Westfield Financial, Inc.	MA	12/28/2001	$49,726
Cheviot Financial Corp.	OH	1/5/2004	$43,884
Clifton Savings Bancorp	NJ	3/4/2004	$137,387
Citizens Community Bancorp	WI	3/29/2004	$9,787
K-Fed Bancorp	CA	3/30/2004	$56,868
Wawel Financial Services, Inc.	NJ	3/31/2004	$7,993
Osage Federal Financial, Inc.	OK	3/31/2004	$6,844
First Federal Financial Services, Inc.	IL	6/28/2004	$17,640
PSB Holdings, Inc.	CT	10/4/2004	$30,897
Home Federal Bancorp, Inc.	ID	12/6/2004	$60,835
Abington Community Bancorp, Inc.	PA	12/16/2004	$71,415
Georgetown Bancorp, Inc.	MA	1/5/2005	$12,498
Rockville Financial, Inc.	CT	5/20/2005	$83,570
Heritage Financial Group	GA	6/29/2005	$32,518
United Financial Bancorp, Inc.	MA	7/12/2005	$76,722
Wauwatosa Holdings Inc.	WI	10/4/2005	$101,171
Greenville Federal Financial Corp.	OH	1/4/2006	$10,343
United Community Bancorp, Inc.	IN	3/31/2006	$36,479
			$1,228,219

Second Step Conversions (9)

Institution	State	Date Completed	Offering Size ($000)
Willow Grove Bancorp, Inc.	PA	4/3/2002	$64,141
Citizens South Banking Corporation	NC	9/30/2002	$52,599
Sound Federal Bancorp, Inc.	NY	1/6/2003	$77,807
Jefferson Bancshares, Inc.	TN	7/2/2003	$66,125
DSA Financial Corporation	IN	7/21/2004	$8,484
Roebling Financial Corporation, Inc.	NJ	9/30/2004	$9,108
American Bancorp of New Jersey	NJ	10/5/2005	$99,188
New England Bancshares, Inc.	CT	12/28/2005	$30,759
First Clover Leaf Financial Corp.	IL	7/11/2006	$41,741
			$408,211

Conversions Pending (3)

Institution	State	Type / Timing	Est Proceeds at Supermax of Range
Viewpoint Bank	TX	MHC / Q3 '06	$116,049
Citizens Community Bancorp	WI	2nd Step / Q4 '06	$55,290
Ben Franklin Bank	IL	MHC / Q3 '06	$8,926
			$180,265

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Recent KBW Credit Union Conversion Summary

Credit Union	Holding Company	State	Proxy Solicitation Completed	Mutal to Stock IPO Date	Date Acquired
IGA Federal Credit Union	Jade Financial Corp	PA	March-98	10/4/1999	11/2/2000
Affiliated Federal Credit Union	BancAffiliated, Inc.	TX	June-98	5/25/2001	—
Pacific Trust Federal Credit Union	First PacTrust Bancorp, Inc.	CA	January-00	8/23/2002	—
AGE Federal Credit Union	HeritageBank of the South, MHC	GA	July-01	—	—
Allied Pilots Federal Credit Union	Allied First Bancorp, Inc.	IL	September-01	12/28/2001	—
Ohio Cetral Federal Credit Union	Ohio Central Savings	OH	September-01	4/1/2005	—
Atlantic Coast Federal Credit Union	Atlantic Coast Federal	GA	October-02	10/5/2004	—
Rainer Pacific Community Credit Union	Rainer Pacific Financial Group	WA	December-01	10/21/2003	—
Kaiser Permanente FCU	K-Fed Bancorp, Inc.	CA	July-03	3/31/2004	—
Citizens Community Credit Union	Citizens Community Bancorp	WI	December-01	3/30/2004*	—
Community Credit Union	ViewPoint Financial Group	TX	February-05	Pending	

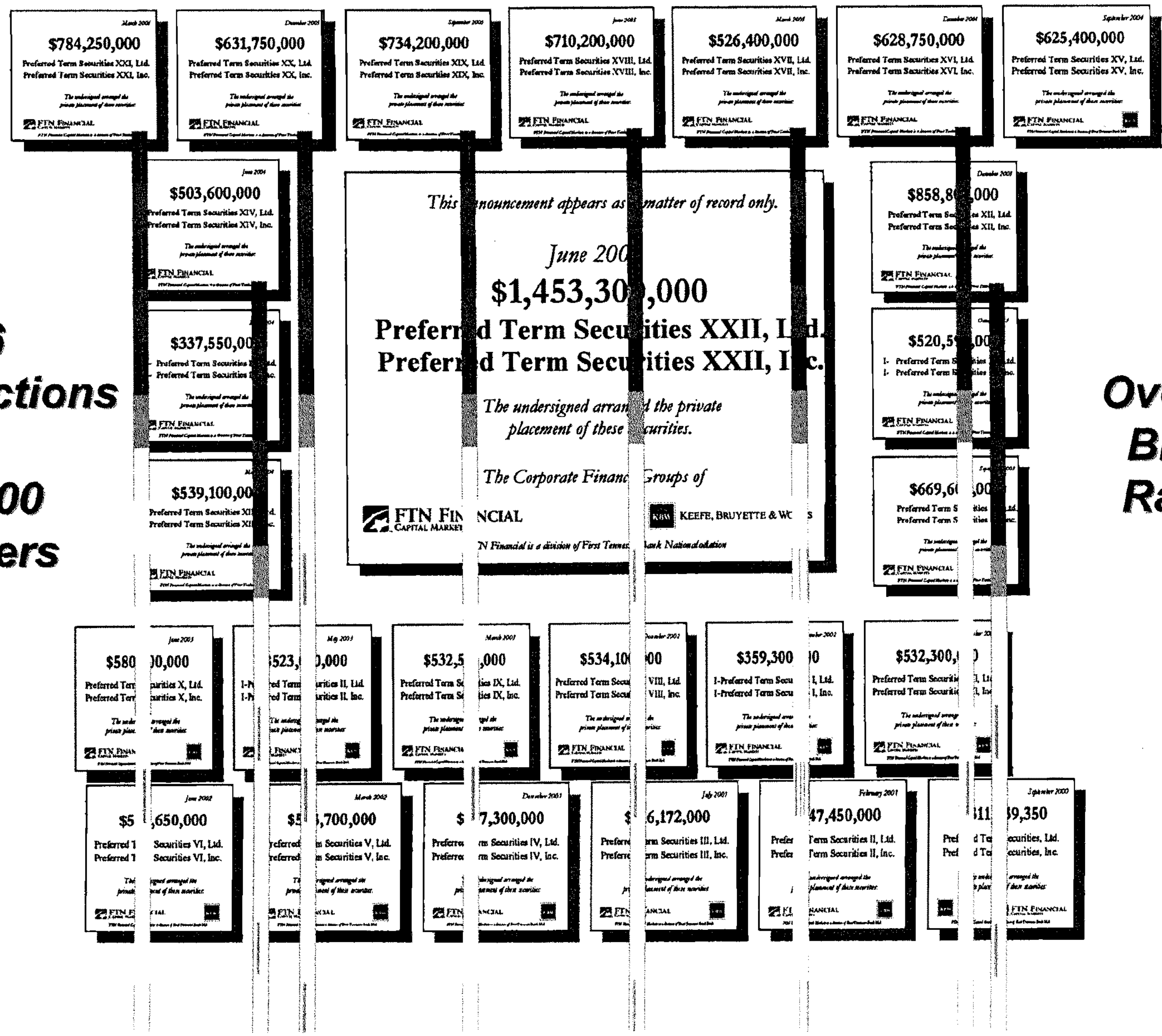
* Citizens Community Bancorp has announced a MHC second step transaction which is estimated to be completed during the 4th quarter of 2006

KBW

The Leader in Pooled Trust Preferreds

26 Transactions

1,500 Issuers



Over $15 Billion Raised

Leading M&A Advisor to US Financial Institutions

KBW is the leading M&A advisor to financial institutions as ranked by number of transactions

Historical Rankings

Year	# of Deals	Deal Value
2004	1	9
2003	1	9
2002	1	3
2001	1	8
2000	1	7
1999	1	9
1998	1	8

2005 M&A Year End Rankings

Volume Rank	Deal Value Rank	Advisor	2005 Number of Deals	2005 Deal Value
1	2	Keefe, Bruyette & Woods, Inc.*	48	$42,288
2	15	Sandler O'Neill & Partners, LP*	44	6,878
3	1	Goldman, Sachs & Company*	25	67,322
4	13	Merrill Lynch & Co., Inc.*	17	8,438
5	3	Morgan Stanley*	16	40,910
6	6	Citigroup Global Markets, Inc.*	16	27,503
7	8	Lehman Brothers, Inc.	13	25,992
8	4	UBS Securities LLC*	10	40,863
9	10	Lazard Freres & Company, LLC*	8	15,592
10	7	Banc of America Securities, LLC*	7	26,765
11	9	J.P. Morgan Securities, Inc.*	7	20,367
12	12	Credit Suisse First Boston (USA), Inc.*	6	8,642
13	11	Bear, Stearns & Company, Inc.	4	9,003
14	5	Joseph Perella	1	35,708
15	14	MTS Health Partners, L.P.	1	7,997

Source: SNL

Note: Represents domestic 2005 bank and thrift, insurance, specialty lender, and securities and investment deals.

The list contains the top 15 companies by total deal value and sorted by number of transactions.

* Deal value for at least one deal is not available

For Bank and Thrift Merger & Acquisition Transactions... the results speak for themselves

KBW is Consistently Among the Leaders in Mergers and Acquisitions Year After Year

KBW Year End Bank & Thrift M&A Rankings

Year	# of Deals	Rank	Deal Value ($M)	Rank
YTD *	23	2	$18,961	4
2005	35	2	$4,247	8
2004	43	1	$13,820	7
2003	35	1	$11,513	3
2002	21	2	$2,824	6
2001	37	1	$6,289	5
2000	19	1	$3,123	7
1999	31	1	$5,092	7
1998	27	2	$8,730	8
1997	30	1	$11,093	7
1996	19	2	$2,441	7

* YTD as of 8/28/2006

Note: Deal Value at announcement

1996 - 2005 Number of Deal Rankings

Financial Advisor Rankings for Announced Bank & Thrift Mergers & Acquisitions Sorted by Number of Deals

Rank	Firm	Number of Deals
1.	Keefe, Bruyette & Woods	301
2.	Sandler O'Neill & Partners, L.P.	241
3.	Hovde Financial LLC	132
4.	Hoefer & Arnett, Inc.	110
5.	Alex Sheshunoff & Co.	106
6.	KeyBanc Capital Markets	90
7.	Merrill Lynch	78
8.	The Carson Medlin Group	73
9.	Professional Bank Services, Inc.	72
10.	Ryan & Beck & Co.	71

1996 - 2005 Deal Value Rankings

Financial Advisor Rankings for Announced Bank & Thrift Mergers & Acquisitions Sorted by Deal Value

Rank	Firm	Deal Value ($M)
1.	Goldman, Sachs & Company	$379,793
2.	Merrill Lynch	262,446
3.	Credit Suisse, Inc.	232,457
4.	Morgan Stanley	197,413
5.	J.P. Morgan Securities, Inc.	154,935
6.	Banc of America Securities	103,614
7.	Lazard Freres & Company, LLC	92,733
8.	Lehman Brothers	82,339
9.	Keefe, Bruyette & Woods	69,254
10.	Sandler O'Neill & Partners, L.P.	53,110

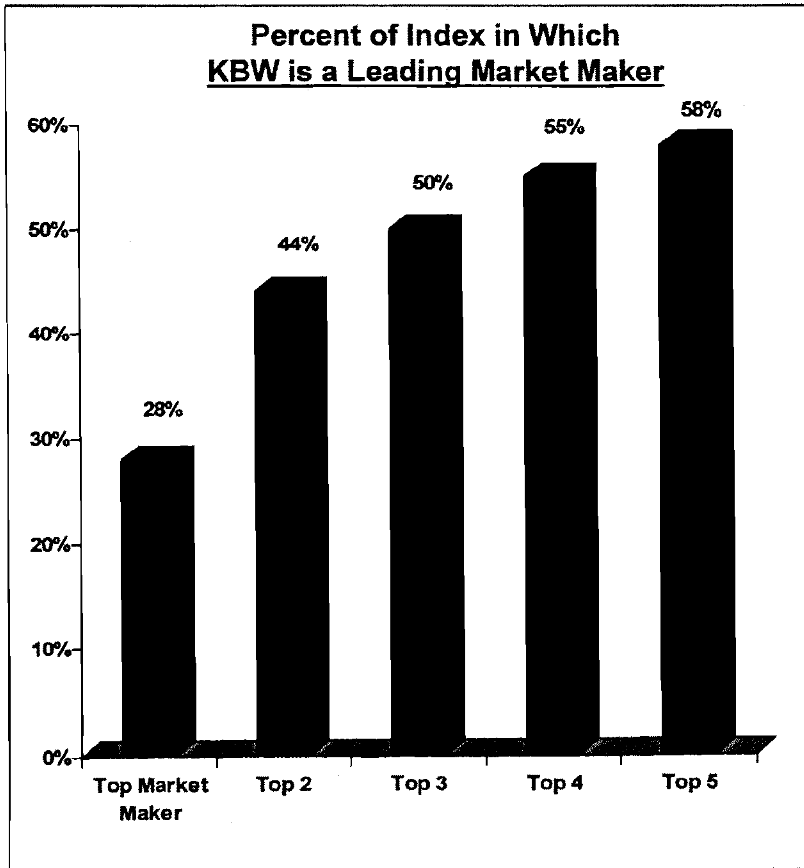
KBW acted as the sole independent fairness opinion advisor to Bank of America in their $35 billion MBNA acquisition

Source: SNL Financial, LC / American Banker

A Leader in Trading Financial Stocks

2005 NASDAQ 100 Advertised Trade Volume

Rank	Broker	Trading Vol. (000)	% Of Total	Sec. Traded
1	Merrill Lynch	867,962	8.5	100
2	Citigroup	782,269	7.6	99
3	Lehman Brothers, Inc.	670,668	6.5	99
4	Credit Suisse First Boston	661,238	6.4	100
5	Morgan Stanley	649,723	6.3	100
6	UBS	625,179	6.1	100
7	Keefe, Bruyette & Woods, Inc.	612,051	6.0	100
8	Knight Equity Markets	476,226	4.6	100
9	Prudential Securities, Inc.	462,884	4.5	86
10	CIBC World Markets	405,512	4.0	98
11	RBC Capital Markets	393,135	3.8	85
12	Goldman Sachs Group	335,501	3.3	100
13	Bear Stearns And Company	263,931	2.6	83
14	Deutsche Bank Securities, Inc.	252,757	2.5	100
15	JPMorgan	248,229	2.4	100
16	Fidelity Capital Markets	172,984	1.7	100
17	Instinet Corporation	143,497	1.4	99
18	Friedman, Billings, Ramsey & Co.	142,834	1.4	71
19	Banc Of America Securities LLC	133,554	1.3	46
20	Cantor, Fitzgerald & Co., Inc.	132,383	1.3	97
21	Sandler O'Neil & Partners, L.P.	128,181	1.3	90
22	SG Cowen Securities Corp.	120,677	1.2	68
23	E-Trade Capital Markets	104,427	1.0	81
24	Robert W. Baird Co. Incorporated	100,586	1.0	21
25	Piper Jaffray & Co.	83,224	0.8	98



Data for year ended December 31, 2005
Source: AutEx/BlockDATA

Case Study: K-FED Bancorp (KFED)

KBW

Strategic Overview and Timeline

- ***November, 1999:*** Kaiser Permanente FCU flips charter from federally chartered credit union to federally chartered mutual savings association. **At the time, Kaiser Federal had assets of $198 million and equity of $28 million.**

- ***July, 2003:*** Kaiser Federal reorganizes into federally chartered mutual holding with out issuing stock ("No stock MHC") and holding company is called K-Fed Bancorp.

- ***March, 2004:*** K-Fed Bancorp conducted minority offering and issued 45% of available shares to depositors of Kaiser Federal Bank (5.6 million shares at $10.00 per share). The stock offering is three times oversubscribed and the stock appreciates 34.9% on the first day of trading under the ticker symbol "KFED" on the Nasdaq National Market.

- ***September, 2004:*** KFED acquired branch office $60 million in deposits from United Pan Am Financial Corp.

- ***March, 2006:*** KFED completes second full fiscal year as a public company. As a result of a combination of strong organic growth, equity raised from the MHC offering, and acquisitions, **Assets have grown to $766 million and equity has grown to $93 million.**

K-FED Bancorp

March 31, 2004 – August 29, 2006 Price / Volume